No. 82-1766

In the Supreme Court of the United States

OCTOBER TERM, 1983

SECURITIES INDUSTRY ASSOCIATION, ET AL., PETITIONERS

v.

BOARD OF GOVERNORS OF THE
FEDERAL RESERVE SYSTEM, ET AL.

ON WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE DISTRICT OF COLUMBIA CIRCUIT

BRIEF FOR THE RESPONDENTS

REX E. LEE
Solicitor General

RICHARD K. WILLARD
Acting Assistant Attorney General

LOUIS F. CLAIBORNE
Deputy Solicitor General

BARBARA E. ETKIND
Assistant to the Solicitor General

ANTHONY J. STEINMEYER
Attorney

Department of Justice
Washington, D.C. 20530
(202) 633-2217

MICHAEL BRADFIELD
General Counsel

RICHARD M. ASHTON
Assistant General Counsel

Board of Governors of the
Federal Reserve System
Washington, D.C. 20551

QUESTION PRESENTED

Whether the court of appeals correctly upheld a ruling by the Board of Governors of the Federal Reserve System that commercial paper—short-term promissory notes issued by large, financially sound businesses in very large denominations to meet their current needs and sold to a small number of financially sophisticated purchasers that regularly purchase short-term credit instruments—is not a security for purposes of the Glass-Steagall Act.

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OPINIONS BELOW

The opinion of the court of appeals (J.A. 220A-257A) is reported at 693 F.2d 136. The opinion of the district court (J.A. 194A-219A) is reported at 519 F. Supp. 602. The statement of the Board of Governors of the Federal Reserve System denying the petitions to initiate enforcement action (J.A. 122A-143A) is not reported. The Board's Policy Statement Concerning the Sale of Third Party Commercial Paper by State Member Banks (J.A. 183A-189A) is reported at 46 Fed. Reg. 29333.

JURISDICTION

The judgment of the court of appeals was entered on November 2, 1982. A petition for rehearing was denied on February 2, 1983 (J.A. 258A-261A). The petition for a writ of certiorari was filed on April 29, 1983, and was granted on October 3, 1983. The jurisdiction of this Court is invoked under 28 U.S.C. 1254(1).

STATUTORY PROVISIONS INVOLVED

1. Section 16 of the Banking Act of 1933, ch. 89, 48 Stat. 184 (the Glass-Steagall Act), as amended, now codified at 12 U.S.C. 24 (Seventh), provides in pertinent part:

> The business of dealing in securities and stock by the [national bank] shall be limited to purchasing and selling such securities and stock without recourse, solely upon the order, and for the account of, customers, and in no case for its own account, and the [national bank] shall not underwrite any issue of securities or stock; *Provided*, That the [national bank] may purchase for its own account investment securities under such limitations and restrictions as the Comptroller of the Currency may by regulation prescribe. * * *

2. Section 21 of the Glass-Steagall Act, 48 Stat. 189, as amended, now codified at 12 U.S.C. 378(a)(1), provides in pertinent part:

> [I]t shall be unlawful * * * [f]or any person, firm, corporation, association, business trust, or other similar organization, engaged in the business of issuing, underwriting, selling, or distributing * * * stocks, bonds, debentures, notes, or other securities, to engage at the same time to any extent whatever in the business of receiving deposits * * * : *Provided*, That the provisions of this paragraph shall not prohibit national banks or State banks * * * from dealing in, underwriting, purchasing, and selling investment securities, or issuing securities, to the extent permitted to national banking associations by [Section 16 of the Glass-Steagall Act] * * *.

STATEMENT

1. Commercial paper refers to unsecured, large-denomination promissory notes that are of prime quality, bear very short maturities, and are issued by large, well-known, and financially strong corporations to obtain

funds for seasonal or other current needs.[1] The commercial paper market is part of the Nation's wholesale money market in which a variety of low-risk, short-term, highly liquid obligations are sold.[2] Examples of other short-term, large-denomination instruments that are sold in the wholesale money market are bankers' acceptances and bank certificates of deposit.[3]

Only about 1,200 firms borrow money in the commercial paper market,[4] either by placing their paper directly or through dealers.[5] Commercial paper placed through dealers usually matures in 60 days or less; a large portion of such paper has maturities of less than 30 days. The minimum denomination of dealer-placed paper is very large, averaging $1 or $2 million per note and almost never less than $100,000.[6]

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[1] Hurley, *The Commercial Paper Market*, 63 Fed. Res. Bull. 525, 527-528 (1977); Hurley, *The Commercial Paper Market Since the Mid-Seventies*, 68 Fed. Res. Bull. 327, 328 (1982); Lowenstein, *The Commercial Paper Market and the Federal Securities Laws*, 4 Corp. L. Rev. 128, 129 (1981); M. Stigum, *The Money Market* 626, 632 (rev. ed. 1983).

[2] Lowenstein, *supra*, at 129; Stigum, *supra*, at 1, 625.

[3] Stigum, *supra*, at 1, 35-36, 39-40. A certificate of deposit is a note evidencing a bank's obligation to pay a specified sum at a fixed maturity. G. Munn & F. Garcia, *Encyclopedia of Banking and Finance* 173-174 (8th ed. 1983). A bankers' acceptance is an order drawn on a bank to pay a specified sum on a specified date (usually several months in the future) that the drawee bank has accepted, *i.e.*, agreed to pay at maturity. Stigum, *supra*, at 39-40, 602.

[4] *The Commercial Paper Market Since the Mid-Seventies*, *supra*, at 327.

[5] As of September 1983, more than one-half of the commercial paper outstanding was placed directly by issuers. 69 Fed. Res. Bull. A24 (Nov. 1983). This case, of course, involves only dealer-placed commercial paper.

[6] Lowenstein, *supra*, at 147; *The Commercial Paper Market*, *supra*, at 525, 528, 530; Stigum, *supra*, at 626, 631. Paper that is placed directly by the issuer may be available in smaller denominations. Hence, it sometimes is purchased by individuals. *The Commercial Paper Market*, *supra*, at 529; *The Commercial Paper Market Since the Mid-Seventies*, *supra*, at 334.

Because it is a wholesale market, commercial paper is not distributed or advertised for sale to the general public. Instead, commercial paper is purchased by large, financially sophisticated purchasers, predominantly institutions such as money market mutual funds, trust departments of banks and, to a lesser extent, life insurance companies, pension funds, nonprofit organizations and nonfinancial corporations. Banks also hold a small amount of commercial paper for their own accounts.[7]

Although commercial paper is unsecured, the market has developed a number of mechanisms to ensure that the obligations are repaid at maturity. Borrowers in the market maintain lines of credit, usually in an amount equal to 100% of their outstanding paper, on which they may draw to repay the paper if they are otherwise unable to do so.[8] Commercial paper also is rated by five independent rating services; unrated or low-rated paper is not readily accepted in the market.[9] Since the default by Penn Central in 1970 on its outstanding commercial paper, which resulted in the widespread establishment of such mechanisms as backup lines of credit, there has not been a single default of substance in the commercial paper market.[10] Reflective of the low risk of paper purchased in the market today is the fact that rates currently paid on commercial paper exceed only slightly those paid on short-term United States government obligations.[11]

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[7] *The Commercial Paper Market Since the Mid-Seventies, supra,* at 327, 333-334; *The Commercial Paper Market, supra,* at 529.

[8] Stigum, *supra,* at 39, 332; *The Commercial Paper Market, supra,* at 530; *The Commercial Paper Market Since the Mid-Seventies, supra,* at 328, 333; Goldman, Sachs am. br. 11.

[9] *The Commercial Paper Market, supra,* at 528-529; *The Commercial Paper Market Since the Mid-Seventies, supra,* at 331-332; Stigum, *supra,* at 635-636. See also pages 40-41, *infra.*

[10] See note 90, *infra.*

[11] Stigum, *supra,* at 638; *The Commercial Paper Market, supra,* at 530.

In sum, commercial paper is a well defined, well recognized instrument, as is evidenced by its exemption from the registration requirements of the Securities Act of 1933, 15 U.S.C. 77c(a)(3),[12] and its exclusion from the definition of the term "security" in the Securities Exchange Act of 1934, 15 U.S.C. 78c(a)(10).[13] Firms serving exclusively as dealers in commercial paper also are not subject to the broker/dealer registration requirements of the 1934 Act, 15 U.S.C. 78o(a)(1). The commercial paper market, like the markets for bankers' acceptances and third-party certificates of deposit, is thus largely self-regulating.[14]

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[12] Section 77c(a)(3) exempts from the registration requirements of the 1933 Act "[a]ny note, draft, bill of exchange, or banker's acceptance which arises out of a current transaction or the proceeds of which have been or are to be used for current transactions, and which has a maturity at the time of issuance of not exceeding nine months, exclusive of days of grace, or any renewal thereof the maturity of which is likewise limited." See also SEC Securities Act Release No. 4412 (Sept. 20, 1961); 26 Fed. Reg. 9158 (1961) (commercial paper that is not registered under the 1933 Act must be of prime quality, not ordinarily purchased by the general public, and issued to facilitate well-recognized types of current operational business transactions).

[13] Section 78c(a)(10) excludes from the definition of "security" for purposes of the 1934 Act "any note, draft, bill of exchange, or banker's acceptance which has a maturity at the time of issuance not exceeding nine months, exclusive of days of grace, or any renewal thereof the maturity of which is likewise limited."

[14] The commercial paper at issue in this case is entirely different from the type of obligation that was involved in *John Nuveen & Co.* v. *Sanders*, 425 U.S. 929 (1976), vacating and remanding 524 F.2d 1064 (7th Cir. 1975). Although labelled "commercial paper," the notes involved in *Sanders* were "offered and sold to the general public" in small amounts (as low as $3,000) and were not of "prime quality." *Sanders* v. *John Nuveen & Co.*, 463 F.2d 1075, 1079 & n.14 (7th Cir.), cert. denied, 409 U.S. 1009 (1972). Moreover, the large majority of purchasers were individuals. *Id.* at 1080 n.18. By contrast, paper placed in the established market is not offered to the general public, sold in small denominations or purchased primarily by individuals. See, *e.g.*, *Zeller* v. *Bogue Electric Manufacturing Corp.*, 476 F.2d 795, 800 (2d Cir.), cert. denied, 414 U.S.

2. During 1978, Bankers Trust Company (Bankers Trust), a New York chartered member bank of the Federal Reserve System, began serving as the agent of several of its corporate customers in placing their commercial paper in the commercial paper market. J.A. 123A, 223A-224A. Petitioners, the Securities Industry Association (SIA), a securities industry trade association, and A.G. Becker, Inc. (Becker), a commercial paper dealer, informally expressed concern to the Board of Governors of the Federal Reserve System about Bankers Trust's commercial paper activities. SIA and Becker subsequently petitioned the Board, among other things, to issue a ruling to the effect that Bankers Trust's activities are unlawful. J.A. 122A.

On September 26, 1980, after considering information obtained through informal discussions with, and written submissions by, the interested parties, as well as through an on-site examination by the Board staff of Bankers Trust's commercial paper activities (J.A. 105A-106A),[15] the Board issued a statement in response to the petitions of SIA and Becker. J.A. 122A-143A. The statement explained the reasons for the Board's conclusion that the commercial paper placed by Bankers Trust is not a security for purposes of the Glass-Steagall Act and therefore is not subject to the Act's prohibitions against underwriting and dealing in securities.[16]

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908 (1973) (referring to the "general notion of 'commercial paper' reflected in [SEC Release 4412]" (see note 12, *supra*)); see also *C.N.S. Enterprises, Inc.* v. *G. & G. Enterprises, Inc.*, 508 F.2d 1354, 1359 (7th Cir.), cert. denied, 423 U.S. 825 (1975).

[15] The staff's examination revealed that Bankers Trust's activities were confined to the recognized, wholesale commercial paper market. The bank was not offering commercial paper to the public but ordinarily placed the paper with institutions that purchase other short-term instruments sold by Bankers Trust. The paper placed by the bank had average minimum denominations of $1 million, matured in approximately 60 days and was purchased by no more than 15 institutions at a time. J.A. 105A-106A.

[16] In view of the Board's disposition of the "securities" issue, it did not reach the question whether Bankers Trust's method of

The Board first observed that Congress did not intend every instrument that could be characterized as a note or security to be subject to the Act's prohibitions on underwriting and dealing (J.A. 126A-135A). Based on the language, legislative history and administrative interpretation of the Act, as well as the underlying legislative purpose to separate commercial and investment banking, the Board found that Congress could not reasonably have viewed instruments with which banks routinely deal as a part of their commercial banking business as the type of "securities" covered by the prohibitions enacted to effect the intended separation. *Ibid.* Accordingly, the Board concluded (J.A. 135A) that "if a particular kind of financial instrument evidences a transaction that is more functionally similar to a traditional commercial banking operation than to an investment transaction, then fidelity to the purposes of the Act would dictate that the instrument should not be viewed as a security."

Applying this standard to the commercial paper placed by Bankers Trust, the Board concluded that these obligations represent a transaction closer to commercial lending than to the sale of an investment. The Board recognized that, by contrast to the commercial paper market as it existed at the time the Glass-Steagall Act was passed, here the paper was being purchased primarily by institutions other than banks. In the Board's view, however, this fact alone did not alter the commercial lending nature of the transaction. Like the traditional commercial loan from a bank, commercial paper is very short-term. Moreover, the paper is purchased in denominations larger than an average investor can afford ($1 million on the average) by a small number of financial institutions and others that, like banks, are sophisticated financially and regularly purchase other types of short-term obligations. The role of Bankers Trust in this case, the

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placing commercial paper constituted "underwriting" or other activity prohibited by the Act with respect to securities (J.A. 140A). The courts below also did not reach this question and it is not at issue in this Court.

Board therefore found, is similar to that of the lead bank in a loan participation or syndication, a traditional function of commercial banks. J.A. 135A-136A.

The Board subsequently issued a policy statement setting forth guidelines designed to ensure that the placement of commercial paper by state member banks would be consistent with the principles of safe banking (the Guidelines) (J.A. 183A-189A). As the court of appeals explained (J.A. 226A n.17), "the guidelines in essence describe Bankers Trust's activities." They thus limit a bank's activities in this area to the recognized commercial paper market by providing that a bank may place only prime quality paper, in large denominations, and only with financially sophisticated customers, and may not advertise any commercial paper for sale to the general public. J.A. 187A.[17]

3. Petitioners sought judicial review of the Board's ruling concerning the applicability of the Glass-Steagall Act to the commercial paper placed by Bankers Trust. The district court rejected the Board's interpretation, finding instead that any obligation that may be characterized as a note is a security for purposes of the Act. J.A. 194A-219A.

The court of appeals reversed (J.A. 220A-257A). It noted at the outset (J.A. 226A) that the district court "gave insufficient weight to the expertise of the Federal Reserve Board—as the agency responsible for administering the nation's banking system—in interpreting the provisions of the Glass-Steagall Act." In the view of the appellate court (J.A. 227A-229A), deference was due to the Board's construction of the statute because of that body's broad authority in numerous areas of banking regulation, its expertise in banking matters, the necessity

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[17] The Guidelines also admonish banks to maintain a complete credit analysis of the corporation issuing the paper, to exercise due diligence in investigating the corporation's financial condition, to maintain adequate records of the bank's operations, not to place paper with fiduciary accounts, and to provide adequate and accurate information to the purchaser concerning the paper being placed (J.A. 187A-189A).

in this case of applying general, undefined terms—notes and securities—to particular facts, and the thorough nature of the investigation undertaken by the Board and the findings made by it as well as their consistency with previous rulings.

The court of appeals did not, however, "rest merely on the deference to the conclusions of the Federal Reserve Board" (J.A. 230A). Instead, recognizing that the courts are the final arbiters of the meaning of a statute, the court of appeals undertook an independent analysis of the application of the Glass-Steagall Act to the facts of this case. Based on its own examination of the language of Sections 16 and 21 of the Act, the relevant legislative history, and the fundamental purposes underlying the Act, the court of appeals found "essentially correct" (*ibid.*) the Board's conclusion that only notes with the characteristics of an investment are securities for purposes of the Act and that the commercial paper placed by Bankers Trust is not such an instrument.

The court observed first (J.A. 231A; footnote omitted) that "Congress'[s] principal concern in [enacting the Glass-Steagall Act] was to protect the solvency and integrity of the banks themselves." The court then turned to an examination of the statutory language, recognizing (J.A. 232A; footnote omitted) that if it "clearly evinces a congressional determination to prohibit the activities in which Bankers Trust has engaged [the] inquiry necessarily comes to an end." To the contrary, however, the court of appeals concluded that both the statutory language and the legislative history "strongly suggest that commercial paper should be viewed as a loan rather than as a 'security' for the purposes of the Act" (J.A. 241A; see also J.A. 235A, 236A). The court determined, for example, that Congress's use of the word "notes" in conjunction with other terms with more specific meanings in the investment banking industry ("stocks," "bonds," and "debentures") strongly implies that notes that lack the investment characteristics of such securities, like com-

mercial paper, were not intended to be covered by the Act (J.A. 232A-236A).[18]

In accordance with the approach taken by this Court in *Investment Company Institute* v. *Camp*, 401 U.S. 617, 635-638 (1971) (*ICI I*), the court of appeals then examined the purposes of the Act in order to determine whether this type of bank involvement with commercial paper would result in the hazards and abuses the Act was designed to eliminate (J.A. 241A-249A). Like the Board, the court of appeals concluded that the commercial paper placed by Bankers Trust has the characteristics of a short-term commercial loan. The court relied on the following factors: the default rate on commercial paper placed in the established market is extremely low, the maturities are short, and the paper is purchased by large institutions and others that have the resources independently to verify representations by and about the issuers. J.A. 244A-246A. While the commercial paper placed by Bankers Trust differs from traditional lending by commercial banks in that funds are provided by other institutions rather than by the bank itself, the court determined that the bank's marketing of commercial paper would not convert the transaction into the sale of an investment since the bank's role does not give rise to the risk of loss and conflicts of interest that the prohibition against bank involvement in the investment banking business was designed to eliminate (J.A. 246A-247A). Based on the absence of serious risk of loss and the ability of purchasers to "fend for themselves," the court of appeals concluded that the bank's marketing of commercial paper would not result in the funds of bank depositors being tied up in speculative investments or result either in the bank's

[18] The court of appeals also agreed with the Board that the definition of a security in the federal securities laws is not determinative of what constitutes a security for purposes of the Glass-Steagall Act since the laws were enacted for fundamentally different purposes. As the court of appeals explained (J.A. 239A-241A), the securities laws were enacted for the protection of investors, while the Glass-Steagall Act was intended to protect banks and their depositors.

abuse of its reputation for prudence or in its provision of unreliable financial advice (J.A. 247A-249A).[19]

Senior Circuit Judge Robb dissented (J.A. 250A-257A). Although he purportedly would have left the question of whether the bank was engaged in underwriting to the Board and the district court on remand (J.A. 257A), in fact his analysis depended almost entirely on the role of the bank (J.A. 251A): "[T]he difference between the bank's role as 'purchaser' in a commercial loan transaction and its role as 'seller' in a third-party commercial paper transaction * * * is determinative under the Act. * * * The critical distinction between commercial banking and investment banking is the bank's role in the transaction."

SUMMARY OF ARGUMENT

A.

Petitioners' argument, simply put, is that because Section 21 of the Glass-Steagall Act refers to "stocks, bonds, debentures, *notes*, and other securities" (emphasis added), the Act's prohibitions on the activities of banks must apply to every instrument that is denominated a "note." It is common ground that commercial paper consists of negotiable promissory notes. Hence, petitioners contend, it is within the reach of the Act.

The dispositive answer to this textual argument is quickly stated. Commercial paper cannot be a "note" or "security" within the prohibition of Sections 16 and 21 of the Act unless it also qualifies as an "investment security," as defined in Section 16. That is so because, on the one hand, the cited sections forbid a commercial bank *even to buy for its own account* any covered security, except only "investment securities," and, on the other

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[19] The court of appeals emphasized (J.A. 250A) that the rationale of its holding necessarily does not apply to other obligations with different characteristics, such as smaller denominations, or that are offered to the public. Such obligations, the court noted, even if referred to as "commercial paper," might be securities under the Act. See also note 14, *supra*.

hand, it is unassailably clear that commercial banks may purchase commercial paper for their own account, as they always have done without objection. Thus, petitioners are relegated to one of two alternative propositions: Either they must assert, against the understanding of everyone in the field, that commercial paper, in all circumstances, fits within the special category of "marketable obligations evidencing indebtedness" that are "commonly known as investment securities," or they must say that commercial paper, although not by nature an investment security, becomes so when a commercial bank performs an intermediary role in placing it. Whatever may be said in favor of the latter argument, it obviously does not turn on the "plain meaning" of the terms "notes" and "securities" in the Glass-Steagall Act.

The provision of the Glass-Steagall Act that is most relevant to this case is Section 16, since it is the section expressly directed to the activities of banks. Our construction of that provision is confirmed when we look at the text as enacted in 1933. Whatever ambiguities there may be in the original language of Section 16, its constant reiteration of the phrase "investment securities" makes it plain that Congress was focusing solely on dealings in instruments bearing the characteristics of an investment. Nor has that focus changed. The amendments effected by the Banking Act of 1935 were labelled "technical" and no one suggests that they substantively altered Section 16. Now, as before, the provision is not concerned with instruments that do not bear the characteristics of an investment.

Petitioners' exclusive reliance on Section 21 is misplaced, not only because Section 16 is the provision of the Act that is directed at the activities of banks, but also because the proviso to Section 21 makes clear that nothing permitted to commercial banks under Section 16 is prohibited to them by Section 21. But even if we look to Section 21, its terms confirm that the Act is concerned only with bank dealings in instruments bearing the characteristics of an investment. To be sure, the word

"note" could embrace any written obligation to pay money, but its context indicates otherwise. Since the term is accompanied in Section 21 by other terms denoting specific, well-recognized types of permanent or long-term securities, Congress also must have used the word "note" in Section 21 in its more specialized, investment sense.

B.

Our analysis is fully supported by the relevant legislative history. As the Court has noted (*Board of Governors of the Federal Reserve System* v. *Investment Company Institute*, 450 U.S. 46, 70 (1981) (*ICI II*)), the Glass-Steagall Act was designed to "separat[e] as completely as possible commercial from investment banking." The Act, however, "surely was not intended to require banks to abandon * * * accepted banking practice[s]." *Id.* at 63.

More specifically, the legislative history of the 1927 McFadden Act, which first contained the narrow definition of "investment securities" re-enacted in Glass-Steagall, makes clear beyond peradventure that commercial paper was not an "investment security" as narrowly defined in Section 16.

Furthermore, the history of the Glass-Steagall Act reveals a distinction in the minds of its draftsmen between commercial paper "notes" on the one hand and "securities" or "investment securities" on the other. Indeed, the draftsmen regarded the purchase of commercial paper by a bank as the equivalent of a commercial loan, a traditional banking function to which the Act was intended to encourage banks to return. This legislative history demonstrates beyond doubt that the sponsors of the Glass-Steagall Act were not targeting the purchase of commercial paper by covered banks.

C.

The commercial paper market has changed markedly since the enactment of the Glass-Steagall Act in 1933. Banks are no longer virtually the only purchasers of commercial paper; the vast bulk of the commercial paper out-

standing today is held by nonbank purchasers. Nevertheless, commercial paper held by large, financially sophisticated institutions other than banks continues to function as the equivalent of a commercial loan to the issuer of the paper. Accordingly, it is immaterial whether the bank, in placing the paper, is engaged in an activity that, if conducted with respect to a security, would be prohibited by the Act. In any event, the role played by the bank in placing the paper is consistent with the view that the paper represents a commercial lending transaction. Because the bank places commercial paper only with large, financially sophisticated purchasers that routinely purchase other short-term credit instruments, the bank in effect is simply arranging a commercial loan from the purchasers to the issuer. Moreover, this activity of the bank gives rise to none of the "hazards" against which the Glass-Steagall Act was directed.

D.

Contrary to petitioners' assertions, the Board is not attempting to "regulate" the underwriting by banks of instruments that are "securities" within the meaning of the Glass-Steagall Act. Rather, the Board's ruling represents a determination that the commercial paper involved here is not a "security" for purposes of the Act and for that reason is not subject to the legislation's prohibitions. Properly viewed as the construction of the statute by the agency charged with its administration, the Board's ruling is entitled to considerable deference.

ARGUMENT

SHORT-TERM, LARGE-DENOMINATION COMMERCIAL PAPER PLACED WITH LARGE, FINANCIALLY SOPHISTICATED PURCHASERS IN THE RECOGNIZED COMMERCIAL PAPER MARKET IS NOT A "SECURITY" WITHIN THE MEANING OF THE GLASS-STEAGALL ACT

The Glass-Steagall Act, originally enacted in 1933 and amended in 1935, prohibits commercial banks from engaging in certain dealings in "securities." Even if we assume that the placing of any debt instrument with a very restricted group of third-party purchasers would qualify as "underwriting" or some other covered activity (a question not decided below and not presented to this Court), the threshold inquiry is whether short-term, large-denomination commercial paper that is bought only by large, financially sophisticated purchasers in the recognized commercial paper market, constitutes a "security" within the meaning of the Act. If not, the case is at an end.

Petitioners' argument, as we understand it, is that the "plain language" of the statute covers every instrument that can be characterized as a "note" or "security," regardless of its investment or commercial nature. We answer that contention with our own textual analysis. But, more fundamentally, our submission is that the purposes of the Glass-Steagall Act, as summarized in this Court's decisions and reflected in the legislative history, make plain that commercial paper was never the subject of the legislation and is not brought within its ambit merely because a commercial bank performs an intermediary role in placing it with other purchasers.

A. The Language And Structure Of The Glass-Steagall Act Demonstrate That The Statute Covers Only Instruments Representing Investments, Not Notes Evidencing Commercial Transactions

All too seldom can a complex issue be decided merely by parsing the bare words of a statute. Nevertheless, obeying the Court's familiar injunction, we begin with

the statutory language. As we shall see, that approach does not yield the result urged by petitioners. On the contrary, focusing only on the text, we are immediately put on guard that the Glass-Steagall Act does not prohibit commercial banks from all dealings in "notes" and "securities" of every description. And, once we trace the operative language through the Statutes at Large, we are very quickly led to the conclusion that instruments bearing the characteristics of an investment alone are the target of the legislation.

1. The most obviously relevant provision of the Glass-Steagall Act is Section 16—the only provision that directly addresses the prohibited and permissible securities dealings of commercial banks.[20] The Section[21] first reaffirms the powers of national banks as including, among other things, "discounting and negotiating promissory notes * * * and other evidences of debts."[22] Then, Section 16 addresses "[t]he business of dealing in securities and stock by [national banks]." Generally, covered banks are prohibited from "purchasing and selling such securities * * * for [the bank's] own account" and from "underwrit[ing] any issue of securities." There follows a proviso permitting commercial banks (subject to regulation by the Comptroller of the Currency) to purchase for their own account limited amounts of "investment securities," defined as "marketable obligations evidencing indebtedness * * * commonly known as investment securities." Redundantly, a national bank is expressly forbid-

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[20] Although by its terms Section 16 applies only to national banks, Section 5(c) of the Glass-Steagall Act, 12 U.S.C. 335, provides that state member banks of the Federal Reserve System are subject to the same limitations and conditions that Section 16 imposes on national banks "with respect to the purchasing, selling, underwriting, and holding of investment securities and stock."

[21] For the Court's convenience, we reproduce in an Appendix, *infra*, 1a-4a, the text of 12 U.S.C. 24 (Seventh), as it stood immediately after its revision by Section 16 of the Glass-Steagall Act, together with the text of the Section as amended by the Banking Act of 1935.

[22] This authority has been part of the National Bank Act since 1864. See the Act of June 3, 1864, ch. 106, § 8, 13 Stat. 101.

den to buy "any shares of stock of any corporation" for its own account. And, finally, a further stipulation exempts certain governmental obligations from "[t]he limitations and restrictions herein contained as to dealing in, underwriting and purchasing for its own account, investment securities."

This is no model of drafting. Yet, some conclusions may be drawn from the face of the text, even if we confine ourselves to the method of English Judges and treat Section 16 as an orphan with no known family history.

We first notice that covered banks are permitted, subject to quantitative limitations, to purchase for their own account specially defined "investment securities." Presumably, this is a particular species belonging to the broader family of "securities and stock" which banks are otherwise forbidden from acquiring except for customers. The excluded species—which covered banks cannot buy for their own account—must be securities, including equity, that are more speculative and involve a greater risk of loss than the approved "investment securities."[23] We could, of course, stop here, having divided the entire universe of financial instruments into two categories: relatively "safe" debt obligations in which banks may invest, and more speculative securities that are barred to them. But this is immediately unsatisfactory.

The problem is that we have not accounted for high quality, low-risk obligations that are not "commonly known as investment securities" because of their very short maturities or their appeal to only a select market—such as commercial paper. We know that commercial banks have always purchased this kind of paper and there is no reason why they ought not be free to do so, given that they may buy some more fluctuating long-term "investment securities" for their own account. Yet, covered banks now *are* prohibited from acquiring these short-term obligations if they must be subsumed within the family

[23] Indeed, exercising the authority expressly given him in Section 16, the Comptroller of the Currency has further defined "investment securities" as excluding investments that are "predominantly speculative in nature." 12 C.F.R. 1.3(b).

of "securities and stock" addressed in Section 16. The only rational explanation is that the Glass-Steagall Act does not reach such obligations at all—because the statute is only concerned to regulate bank dealings in instruments representing investments.

In sum, the universe of debt obligations is divided into *three*, not two parts: (1) speculative securities that (like stock) commercial banks cannot touch except as agents for their customers; (2) special "investment securities" that they may purchase for their own account but cannot otherwise deal in; and (3) other obligations (including, but not limited to, commercial loan notes) that commercial banks are free to buy and sell or place for others.[24] Since it is common ground that banks may purchase commercial paper, it cannot fall within the first category.[25] And yet, as we show in a moment, commercial paper does not qualify as an "investment security," as narrowly defined in Section 16. Hence, commercial paper must be in the last of our categories, unregulated by the Glass-Steagall Act.

2. Our reading of Section 16 as it now appears in the statute book is confirmed if we look at the original text

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[24] We put to one side the government securities mentioned in Section 16 that commercial banks may purchase without limit. For present purposes, it is irrelevant whether these are viewed as a subclass of category (2) "investment securities" or a distinct fourth category.

[25] Although the authority of national banks to continue to purchase commercial paper for their own accounts might be predicated on the pre-existing power, conferred by the National Bank Act of 1864, to "discount[ ] and negotiat[e] promissory notes" (12 U.S.C. 24 (Seventh)), that authorization does not extend to state-chartered member banks. Even if state law afforded state banks analogous "discount and negotiate" power, such authority would have been preempted by the Glass-Steagall Act's proscription on banks purchasing securities for their own accounts if commercial paper constituted a "security." Accordingly, the fact that state-chartered as well as national banks continued to buy commercial paper for their own accounts after enactment of Glass-Steagall demonstrates that such paper plainly is not a "security" other than an "investment security" within the meaning of the Act.

enacted in 1933, before its amendment by the Banking Act of 1935.

In the Glass-Steagall Act of 1933, the relevant portion of Section 16 was addressed exclusively to national bank involvement with what were termed "*investment* securities" (emphasis added). That term was repeated no less than six times in the 1933 Section. It was obviously carried forward from the McFadden Act of 1927, ch. 191, 44 Stat. 1224 *et seq.*, itself an amendment to the National Bank Act, which authorized covered banks to engage, in a limited way, in "the business of buying and selling investment securities." Now, in 1933, that authorization was cut back. But the focus remained the same: the connection between national banks and instruments bearing the characteristics of investment.

To be sure, "investment securities," as used in the original Glass-Steagall Act, was perhaps too narrow if the term was always to be understood in the restrictive sense of the definition provided in Section 16. And that presumably explains why the word "investment" was omitted when the expression was replaced by "securities and stock" in 1935. See Banking Act of 1935, ch. 614, § 308(a), 49 Stat. 709. Henceforth, the term "investment securities" was reserved as a definition of the restricted category of securities that national banks may purchase for their own account. There is, however, no basis for reading more in the 1935 amendments than an intent to tidy a careless text.

In light of the legislative history of these amendments, no such claim has or could be made.[26] There is, in any

[26] Straying a moment from the statutory text, we note that the hearings and reports on the 1935 amendments to Section 16 and 21 of the Glass-Steagall Act indicate only one purpose: to make clear that although commercial banks may not purchase stock for their own account or deal in it, they may act as stock brokers for their customers. See H.R. Rep. 742, 74th Cong., 1st Sess. 18 (1935); *Banking Act of 1935: Hearings on H.R. 5357 Before the House Comm. on Banking and Currency*, 74th Cong., 1st Sess. 663 (1935); *Banking Act of 1935: Hearings on S. 1715 and H.R. 7617 Before a Subcomm. of the Senate Comm. on Banking and Currency*, 74th Cong., 1st Sess. 114, 153 (1935). There is no hint of any larger

event, internal evidence against reading the amendments as working a change of law. They are expressly labelled "technical amendments," and, without going afield, we can discern the need for them by noting the imperfections of the 1933 text. We are, moreover, given another internal clue in the formulation of the new proviso added to Section 21. See First Proviso added by Section 303(a) of the Banking Act of 1935, 49 Stat. 707. There, Section 16 is described as granting commercial banks limited permission to deal in "*investment* securities" (emphasis added). This may be a partial lapse in view of the linguistic revisions now made to Section 16. But it is hardly credible that the old terminology would have been retained if those revisions had been understood to effect a major substantive change.[27]

The upshot is that the Glass-Steagall Act, before and after its amendment, focused solely on dealings in instruments bearing the characteristics of an investment, whether in the narrow sense of the specially defined "investment securities" or more broadly. And, as we demonstrate in a moment, commercial paper simply does not fit that mold.

3. Recognizing, apparently, that commercial paper is within neither the "investment security" nor the other "security" prong of Section 16, petitioners rely instead on Section 21, arguing that because commercial paper consists of promissory notes it is within that Section's ban on the issuance, underwriting, selling or distributing of "stocks, bonds, debentures, notes, or other securities." 12 U.S.C. 378(a)(1). The full answer, it would seem, is in the proviso to Section 21 added in 1935, which makes

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purpose, as petitioners apparently recognize. See, *e.g.*, H.R. Rep. 742, *supra*, at 2 ("amendments make no fundamental changes in the existing banking laws").

[27] Likewise, Section 5(c) of the Glass-Steagall Act, 12 U.S.C. 335, which makes state member banks of the Federal Reserve System subject to the same limitations and conditions with respect to "investment securities and stock" as are imposed on national banks by Section 16 (see note 20, *supra*), has never been amended to reflect the changes in terminology wrought by the 1935 Act.

clear that nothing permitted to commercial banks under Section 16 is prohibited to them by Section 21. That is what we would expect: After all, Section 16 is the provision of Glass-Steagall that is specifically addressed to banks and it would be peculiar if greater restrictions on their activities were to be found in a provision that was directed at non-banking institutions. Indeed, petitioners themselves concede that the two provisions are "co-extensive" (Becker Br. 24; see also SIA Br. 14; ICI am. br. 8).

But if, notwithstanding the proviso, we look to the terms of Section 21, no different conclusion emerges. Section 21's prohibitions apply to "stocks, bonds, debentures, notes, or *other securities*" (emphasis added). When this provision is read together with Section 16 (as petitioners acknowledge it should be (SIA Br. 14; see also Becker Br. 24-26)), it strongly suggests that only those instruments that are "securities" ("investment" or other) for purposes of Section 16 will also be covered by Section 21's prohibitions. In any event, when the term "notes" is properly read in the context of the provision as a whole, it is clear that the reference is only to notes representing investments.

The words "stocks," "bonds," and "debentures" all refer to specific, well recognized types of permanent or long-term securities. Stocks, of course, represent ownership interests in a corporation.[28] Bonds are secured debt instruments, issued under a trust indenture agreement, that are sold to the public generally in small denominations (usually $1,000) and that bear maturities of from five to 30 years or longer.[29] "Debentures" are debt instruments similar to bonds in all respects except that they are unsecured.[30] Public issues of stocks, bonds, and de-

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[28] 1 A. Dewing, *The Financial Policy of Corporations* 55 (5th ed. 1953).

[29] Dewing, *supra*, at 168, 171-174, 176-179.

[30] W. Husband & J. Dockeray, *Modern Corporation Finance* 170 (6th ed. 1966).

bentures typically are registered with the Securities and Exchange Commission.

The word "notes," however, is susceptible to more than one meaning. On the one hand, the term is used in the investment banking industry to refer to debt obligations that, like bonds and debentures, are distributed to the public in small denominations under an indenture agreement, but that bear shorter maturities than bonds or debentures—usually from one to five years.[31] On the other hand, the term also is used in a generic fashion to refer to any written obligation to pay money.[32] When employed in this latter sense, the word "notes" encompasses a broad universe of instruments that have no close relationship to investment banking: handwritten I.O.U.'s, Federal Reserve notes (currency), bank deposit receipts, loan notes for the purchase of consumer goods, or notes representing a loan to a business.

Where a word "capable of many meanings" is used in conjunction with words of more limited meaning, it is limited and qualified by the specific words surrounding it "in order to avoid the giving of unintended breadth to the Acts of Congress." *Jarecki* v. *G.D. Searle & Co.*, 367 U.S. 303, 307 (1961).[33] Hence, the fact that Congress included the word "notes" in a list of other terms, each of which refers to a specific type of *investment* instrument, makes clear that Congress used the term "notes" in Section 21 of the Act not to connote all instruments that can be characterized as notes, but only notes of an investment character. Indeed, if the broad, generic meaning of "notes" were intended, it would have been unnecessary for Congress to specify "bonds" or "debentures" in the stat-

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[31] Dewing, *supra*, at 178.

[32] G. Munn & F. Garcia, *Encyclopedia of Banking and Finance* 724 (8th ed. 1983).

[33] See also *Third National Bank* v. *IMPAC, Ltd.*, 432 U.S. 312, 322 (1977) (citing the "familiar principle of statutory construction that words grouped in a list should be given related meaning"); *Jarecki* v. *G.D. Searle & Co.*, 367 U.S. at 307 ("a word is known by the company it keeps").

ute, since "notes" would have encompassed all debt securities.[34]

By using the words "notes" and "securities" in Section 21 in conjunction with other terms that refer to specific types of long-term investments, Congress indicated on "the face of the statute" (*Jarecki* v. *G.D. Searle & Co.*, 367 U.S. at 307-308) that these words should be interpreted in accordance with their specialized, investment meanings. Contrary to petitioners' contentions, the Board's interpretation does not result in engrafting nonstatutory limitations into the Act; the limitations on "notes" and "securities" are inherent in the manner in which the words are arranged in the statute. The statutory text itself directs us to examine the particular instrument to determine whether it shares that characteristic of an investment that is the common feature of each of the other enumerated instruments. The construction urged by petitioners, which would bring every instrument that can be characterized as a note within the ambit of the Act's prohibition, wrenches isolated words both from the statutory context in which Congress used them and from the underlying congressional purpose to separate investment banking from commercial banking (see pages 24-25, *infra*).[35]

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[34] For the same reasons, the term "other securities" also was not meant to refer to all notes. SIA's suggestion (Br. 12) that the juxtaposition of the words "notes" and "other securities" in Section 21 indicates that commercial paper, because it consists of promissory notes, must also be a "security" rests on petitioners' erroneous assumption that the term "notes" in Section 21 encompasses every instrument that may be denominated a note regardless of its commercial or investment nature.

[35] Particularly with respect to Glass-Steagall, this Court has recognized that words in the Act gather meaning from other words in the statute as well as from the underlying legislative purpose. See *Board of Governors of the Federal Reserve System* v. *Agnew*, 329 U.S. 441, 447-449 (1947) (meaning of the phrase "engaged primarily" in Section 32 of the Act, 12 U.S.C. 78, determined by reference to the meaning of the phrase "engaged principally" in Section 20 of the Act, 12 U.S.C. 377, as well as to "the evil at which the section was aimed"). See also *Philbrook* v.

Moreover, petitioners' overbroad construction of the Act would bar many other commonly accepted banking functions. Since enactment of the Glass-Steagall Act banks have continued to engage in the marketing of notes not having the characteristics of an investment. For example, banks in effect sell note obligations to other lenders in arranging loan participations and buy and sell as dealers certificates of deposit and bankers' acceptances issued or accepted by other financial institutions. If petitioners were correct in arguing that every note is a "security" for purposes of the Glass-Steagall Act, these activities also would be prohibited by the Act.

B. The Legislative History Demonstrates That When Commercial Paper Is Purchased By A Bank For Its Own Account It Is Not A "Security" For Purposes Of The Glass-Steagall Act

The textual exegesis we have just undertaken, if not dispositive, carries us a long way to the conclusion that bank dealings in commercial paper were never intended to be inhibited by the Glass-Steagall Act, as originally enacted in 1933 or as amended in 1935. But any lingering doubts are put to rest when we leave the text and notice the legislative history of the relevant sections.

1. The central purpose of the Glass-Steagall Act has long since been identified by the Court itself and we need not retrace that ground in more than a few words. The statute was passed in reaction to the recent financial disaster that had included the failure of many banks and

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Glodgett, 421 U.S. 707, 713 (1975), quoting *United States* v. *Heirs of Boisdore*, 49 U.S. (8 How.) 113, 122 (1849).

The construction adopted by the Board and the court of appeals, moreover, is not inconsistent with the views expressed by this Court in *ICI I*, 401 U.S. at 635. In *ICI I*, it was unnecessary for the Court to reach the question of the extent to which debt obligations are covered by the Act, since that case involved equity interests in "the business of buying, holding, and selling stocks for investment." *Ibid.* Furthermore, the Court's dictum (*ibid.*) to the effect that the word "securities," as used in the Act, is broad enough to include "securities representing debt" does not suggest that *all* debt instruments are securities within the meaning of the Act.

the ruin of their depositors. Congress believed that commercial banks had significantly contributed to this result by their securities dealings, especially "perilous underwriting operations" and "stock speculation," and, accordingly, was determined to "separate[] as completely as possible commercial from investment banking." *ICI II*, 450 U.S. at 61-62, 70.

The particular concerns that animated Congress in divorcing commercial banks from the investment securities business have been fully catalogued. *ICI II*, 450 U.S. at 66-67; *ICI I*, 401 U.S. at 630-633. The most obvious threat to bank solvency was that, through misjudgment or misfortune, a bank might be forced to commit its own assets to hold illiquid and unmarketable securities. The "more subtle" dangers included the possibility that if investments sold by the bank proved unsuccessful, the bank, fearing loss of public confidence and good will, might make unsound loans to shore up its own securities operation or the businesses whose securities the bank was selling. There was also concern that banks would use their credit facilities to support speculative investment in securities, rather than for the service of "agriculture and commerce and industry." *ICI I*, 401 U.S. at 632 n.29. Finally, Congress feared that involvement in the investment banking business would prejudice a commercial bank's ability to provide reliable investment advice or might tempt it to unload securities it was unable to sell in accounts the bank managed as trustee.

In sum, the focus of the Glass-Steagall Act was on the perils of permitting commercial banks to return to the investment securities business. This alone strongly suggests that Congress was not addressing transactions in commercial paper, which were never viewed as the source of the problem. But we need not guess about it. There is ample indication in the legislative history that involvement in commercial paper was deemed a *proper* part of the commercial banking business.

2. Bank involvement in the commercial paper market can be traced back to the first banks organized in this country. A. Greef, *The Commercial Paper House in the*

United States 6-7, 15-18 (1938). Before the banking system developed extensive branching systems, the transfer of surplus, loanable funds from banks in one geographic locale to banks in other areas was difficult. Thus, borrowers whose local bank had no lendable funds at a certain time would place their loan notes, often through middlemen, with banks in capital surplus areas.[36]

Although banks purchased such obligations in the open market, through middlemen or directly, commercial paper held by a bank for its own account traditionally was treated for bank regulatory purposes as the making of a commercial loan by the bank, not as the purchase of an investment. Throughout this period and continuing to the present time commercial paper purchased by banks has been reported in the bank's public report of condition as a commercial loan, not as the purchase of a security. Greef, *supra*, at 173; J.A. 130A.

In 1927, Congress amended the National Bank Act of 1864 by enacting the McFadden Act, which recognized the legality of the then existing practice of national banks of dealing in and underwriting corporate bonds.[37] The Act provided that the business of buying and selling investment securities by a national bank "shall hereafter be limited to buying and selling without recourse marketable obligations evidencing indebtedness of any person, copartnership, association, or corporation, in the form of bonds, notes and/or debentures, commonly known as investment securities" subject to certain limitations based on the bank's capital.[38] The legislation's sponsor made crystal clear that the term "investment securities" as

[36] There is some evidence that banks also served as dealers in commercial paper well before their entrance into the investment banking business in the 1920s. Before 1840, banks in various parts of the country were buying and selling commercial paper notes, either directly or through brokers. Greef, *supra*, at 15-18. "During the later years of [1861 to 1914] * * * some few banks even acted as regular dealers in commercial paper." *Id.* at 63.

[37] McFadden Act of 1927, ch. 191, § 2, 44 Stat. 1226-1227; see H.R. Rep. 83, 69th Cong., 1st Sess. 3-4 (1926).

[38] § 2(b), 44 Stat. 1226.

used in the Act did not include commercial paper, which was subject to the separate limitations on the amount of a bank's commercial loans.[39]

As discussed more fully above (pages 15-20, *supra*), when Congress again amended the National Bank Act six years later by passing the Glass-Steagall Act, it restricted dramatically the authority of national banks to deal in bonds and debentures. However, banks continued to be permitted to purchase certain "investment securities" for their own accounts *and this definition was not changed* by the Glass-Steagall Act or by the 1935 amendments.[40] Accordingly, commercial paper is no more an "investment security" within the proviso to Section 16 today than it was in 1927 or 1933. Because commercial paper plainly is not a "security" other than an "invest-

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[39] The following colloquy between Representatives McFadden and Wainwright is reported at 67 Cong. Rec. 3232 (1926) (emphasis added):

> MR. WAINWRIGHT. * * * I would like to ask the chairman of the committee about this limitation, which seems to be new, of 25 per cent of capital and surplus to be invested in any one security. How does it affect the limitation of 10 per cent provided in section 5200 of the Revised Statutes of the amount of any loan to any one interest or any one maker?
>
> MR. McFADDEN. This is an investment section and attempts to legalize that which the banks are doing now without authority of law. It does put a limitation on the amount of money they can use for investment purposes, such as underwritings, and we felt that there should be this limitation. I do not think it has any application to the question the gentleman raises provided for in section 5200 of the Revised Statutes.
>
> MR. WAINWRIGHT. *Let me ask the gentleman whether commercial paper, as generally understood and accepted, is regarded as investment security.*
>
> MR. McFADDEN. *No; it is not. Commercial paper comes under the limitation of section 5200 in the Revised Statutes. I never have known of commercial paper being construed as investment securities.*

Section 5200, now codified at 12 U.S.C. 84, continues to subject a bank's purchase of commercial paper for its own account to its lending limits.

[40] Compare 44 Stat. 1226 with 48 Stat. 185 and 49 Stat. 709.

ment security" (see pages 17-18, *supra*), it follows that commercial paper, at least when it is purchased by a bank, is not a "security" for purposes of the Act.

In addition, the legislative history of the Glass-Steagall Act itself recognizes the distinction between commercial paper "notes" on the one hand and "securities" or "investment securities" on the other. Indeed, the draftsmen of the Glass-Steagall Act regarded the purchase of commercial paper by a bank as the equivalent of a commercial loan, a traditional banking function to which the Act was intended to encourage banks to return. For example, the Senate Report decried "a loose banking policy which had turned from the making of loans on commercial paper to the making of loans on security." [41] In a similar vein, Senator Walcott, a manager of the bill that became the Act, stated:

> [F]rom 1924 or 1925 to 1929 * * * a complete change in our banking system [occurred] in the respect that business enterprises all over the United States began to finance their requirements by the sale of their own *securities* rather than by borrowing at the commercial banks upon their *commercial paper*—that is, upon their *notes.* * * *
>
> The commercial banking business in consequence of this extraordinary volume of security business declined. The banks had to change to a large extent their method of handling business. There was no longer the great demand for borrowing on commercial paper.[42]

Senator Glass, the chief draftsman of the Act,[43] also contrasted commercial paper with investment securities:

> In their open-market operations [the Federal Reserve Banks] have never bought a dollar of commercial

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[41] S. Rep. 77, 73d Cong., 1st Sess. 4 (1933).

[42] 75 Cong. Rec. 9904 (1932) (emphasis added).

[43] 75 Cong. Rec. 10072 (1932) (remarks of Sen. Glass).

paper. * * * They have bought investment securities.[44]

In sum, the criticism was that commercial banks had abandoned commercial paper in favor of investment in "securities." And what the Act was designed to end was bank dealings in *long-term* obligations. Thus, the Senate Report on the proposed legislation described as "a very fruitful cause of bank failures * * * the fact that the funds of various institutions have been so extensively 'tied up' in *long-term* investments." [45] Similarly, in his lengthy explication of the securities prohibitions of the Act, Senator Bulkley defined the affiliates targeted by the Act as corporations "operating in the *long-term* capital market in competition with the investment houses." [46] He also identified investment banking as "the mechanism for the supply of *long-term* funds to industry and to Government borrowers" [47] and spoke of the evils and hazards that result when a securities affiliate "hold[s] *long-term* securities" of a kind which the bank is not permitted to hold.[48] He further decried banks venturing forth into the "*long-term* capital market" [49] and encouraging borrowers seek-

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[44] 75 Cong. Rec. 9885 (1932).

Numerous other statements made during the hearings and floor debate on the legislation indicate an understanding that commercial paper is not a "security." *E.g., Operation of the National and Federal Reserve Banking Systems: Hearings on S. 4115 Before the Senate Comm. on Banking and Currency,* 72d Cong., 1st Sess., Pt. I, 146 (1932) (remarks of Sen. Glass) (banking system has favored bonds and securities rather than commercial paper); *id.* at 66-67 (remarks of President of American Bankers Association) (distinction between credit on notes and accommodation on marketable securities); *Operation of the National and Federal Reserve Banking Systems: Hearings Pursuant to S. Res. 71 Before a Subcomm. of the Senate Comm. on Banking and Currency,* 71st Cong., 3d Sess., App., Pt. VII, 1006-1019 (1931).

[45] S. Rep. 77, *supra,* at 8 (emphasis added).

[46] 75 Cong. Rec. 9909 (1932) (emphasis added).

[47] 75 Cong. Rec. 9909 (1932) (emphasis added).

[48] 75 Cong. Rec. 9909 (1932) (emphasis added).

[49] 75 Cong. Rec. 9910 (1932) (emphasis added).

ing to raise "*long-term* funds" to issue securities to be sold to the depositors of the bank.[50] By contrast, the legislative history is devoid of any congressional concern about bank involvement with short-term notes in general or with commercial paper in particular.

3. It is telling that petitioners' description (SIA Br. 17-21; Becker Br. 29-35) of the legislative history largely ignores the Glass-Steagall Act itself and relies instead on the history of other legislation, most of which was enacted by subsequent Congresses.[51]

Petitioners' reliance on various provisions of the Securities Act of 1933, the Securities Exchange Act of 1934, and the Public Utility Holding Company Act of 1935, suffers from the same infirmity: all of these laws were enacted for reasons far different from the considerations that underlay the enactment of the Glass-Steagall Act.[52] As noted above, the Glass-Steagall Act was designed to protect *banks and their depositors* from insolvencies "partially attributable to the connection between commercial banking and investment banking." *ICI II*, 450 U.S. at 61. By contrast, the "primary purpose" of the securities legislation of 1933 and 1934 was to eliminate abuses from "the capital market of the enterprise system" and "to prevent fraud and to protect the interests of *investors*." *United Housing Foundation, Inc.* v. *Forman*, 421 U.S. 837, 849 (1975) (emphasis added); see also *Marine Bank* v. *Weaver*, 455 U.S. 551, 555 (1982) (the 1934 Act "was adopted to restore *in-*

[50] 75 Cong. Rec. 9912 (1932) (emphasis added).

[51] "[T]he views of a subsequent Congress form a hazardous basis for inferring the intent of an earlier one." *Consumer Product Safety Commission* v. *GTE Sylvania*, 447 U.S. 102, 117 (1980), quoting *United States* v. *Price*, 361 U.S. 304, 313 (1960).

[52] The fact that Congress declined to include in the Banking Act of 1935 a proposal to permit banks to underwrite and sell "bonds, debentures and 'notes'" under regulations prescribed by the Comptroller of the Currency (see Becker Br. 31; S. Rep. 1007, 74th Cong., 1st Sess. 16 (1935)) is entitled to no probative weight since there is no evidence that the proposed amendment was intended to apply to short-term notes like commercial paper.

vestors' confidence in the financial markets") (emphasis added).[53] In short, the Glass-Steagall Act and the securities laws were intended to serve widely divergent aims;[54] the scope of what constitutes a "security" for each therefore need not be the same in order to accomplish the congressional objectives. Even where they are enacted by the same Congress as part of a comprehensive legislative effort, separate statutes that "play different roles in achieving * * * broad, common goals" are not construed similarly or in pari materia. *Erlenbaugh* v. *United States*, 409 U.S. 239, 245 (1972). Accordingly, the legislative history on which petitioners rely is not determinative or even reliable evidence in construing the Glass-Steagall Act.[55]

Reference to the securities laws definitions for purposes of construing the word "security" in the Glass-Steagall Act is inappropriate for another reason as well. The 1933 Act, the 1934 Act and the Public Utility Holding Company Act of 1935 all define the term "security" as meaning, unless the context otherwise requires, "*any* note

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[53] The Public Utility Holding Company Act of 1935, 15 U.S.C. 79 *et seq.*, was designed to protect investors, consumers, and the general public from the false or misleading solicitation for securities of public utilities and from the adverse economic effects resulting from their complex and inefficient organizational structure. See 15 U.S.C. 79a(b).

[54] As Senator Bulkley explained (75 Cong. Rec. 9913-9914 (1932)):

> [T]he purpose of [the Glass-Steagall Act] does not extend to safeguarding purchasers of securities as such. The purpose of this bill is to improve the operation of the Federal reserve system and the banks which are members of it. The object of the inhibitions which I am discussing here is not primarily to protect the investing public, although that is a worthy purpose, but our field is to protect the operations of the banking system itself, and to protect the depositors and customers of the banks so that they shall have the service from national and State member banks which they are entitled to expect.

[55] In construing the meaning of the word "security" as used in Sections 16 and 21 in *ICI I*, this Court made no reference to the securities laws definitions.

* * *." 15 U.S.C. 77b(1), 78c(a)(10), 79b(a)(16). On its face, such language is more encompassing than the word "notes" as it is used in Section 21, *i.e.*, in a list of specific, long-term debt securities.

Finally, it is not even clear that the commercial paper involved here would constitute a security within the meaning of the securities laws provisions on which petitioners rely. Following this Court's lead,[56] the lower courts now uniformly look to the economic realities underlying the particular transaction in order to determine whether an instrument denominated as a note is a "security" within the meaning of the securities acts. Indeed, several courts have employed precisely the investment/commercial distinction that was applied by the Board and court below; on that basis, they have found long-term notes of a commercial nature not "securities" within the meaning of the securities laws and short-term notes of an investment nature covered by those laws, notwithstanding the express exclusion from the 1934 Act and the registration requirements of the 1933 Act for short-term notes only (see notes 12 & 13, *supra*).[57]

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[56] See, *e.g.*, *Marine Bank* v. *Weaver*, *supra*; *United Housing Foundation, Inc.* v. *Forman*, *supra*.

[57] See *American Bank & Trust Co.* v. *Wallace*, 702 F.2d 93, 96-97 (6th Cir. 1983); *Williamson* v. *Tucker*, 645 F.2d 404, 426-429 (5th Cir. 1981); *National Bank of Commerce* v. *All American Assurance Co.*, 583 F.2d 1295, 1300-1302 (5th Cir. 1978); *Emisco Industries, Inc.* v. *Pro's, Inc.*, 543 F.2d 38, 40-41 (7th Cir. 1976); *C.N.S. Enterprises, Inc.* v. *G. & G. Enterprises, Inc.*, 508 F.2d 1354, 1359-1363 (7th Cir.), cert. denied, 423 U.S. 825 (1975); *Zabriskie* v. *Lewis*, 507 F.2d 546, 550-552 (10th Cir. 1974); *McClure* v. *First National Bank*, 497 F.2d 490, 492-495 (5th Cir. 1974), cert. denied, 420 U.S. 930 (1975); *Bellah* v. *First National Bank*, 495 F.2d 1109, 1111-1114 (5th Cir. 1974); *Lino* v. *City Investing Co.*, 487 F.2d 689, 694-696 (3d Cir. 1973); *Zeller* v. *Bogue Electric Manufacturing Corp.*, 476 F.2d 795, 799-800 (2d Cir.), cert. denied, 414 U.S. 908 (1973); *Sanders* v. *John Nuveen & Co.*, 463 F.2d at 1077-1080. See also *Amfac Mortgage Corp.* v. *Arizona Mall of Tempe, Inc.*, 583 F.2d 426, 431-434 (9th Cir. 1978); *Great Western Bank & Trust* v. *Kotz*, 532 F.2d 1252, 1256-1260 (9th Cir. 1976).

Petitioners rely (Becker Br. 30-31) on the fact that the securities acts and the Public Utility Holding Company Act of 1935 contain

C. Commercial Paper Retains The Characteristics Of A Commercial Loan When It Is Purchased By Large, Financially Sophisticated Institutions Other Than Banks; The Bank's Role In The Transaction Does Not Give Rise To The "Hazards" Against Which The Glass-Steagall Act Was Directed

What we have said demonstrates beyond doubt that the sponsors of the Glass-Steagall Act were not targeting the purchase of commercial paper by covered banks. Accordingly, the Act did not intend to embrace commercial paper as a "security," dealing in which was prohibited to commercial banks. That was, of course, at a time when banks were virtually the only purchasers of commercial paper [58] and only very seldom acted as intermediaries for other buyers of this paper. The situation is now markedly changed. Today, the vast bulk of the commercial paper outstanding is held by money market mutual funds, bank trust departments and, to a lesser extent, life insurance companies, pension funds, nonprofit organizations and nonfinancial corporations. The argument is therefore made that the role of the bank in placing this paper with these other purchasers somehow changes its character and brings it within the category of "securities" that the

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specific exemptions from some or all of their provisions for commercial paper as evidence that commercial paper is not excluded from the term "security" as used in the Glass-Steagall Act. But it was Senator Glass himself, the principal draftsman of the Glass-Steagall prohibition on securities activities, that made the proposal to amend the definition of "security" in the 1933 Act to exclude short-term notes on the ground that they did not constitute securities. See *Securities Act: Hearings on S. 875 Before the Senate Comm. on Banking and Currency*, 73d Cong., 1st Sess. 98 (1933). Contrary to the implication drawn by petitioners, in light of Senator Glass's view, his failure to seek to amend the Glass-Steagall Act to exclude short-term notes from its coverage strongly suggests that he viewed such an amendment as unnecessary because the Act was never intended to cover such instruments.

[58] During the 1930s, banks purchased approximately 95% of the commercial paper sold. A. Greef. *The Commercial Paper House in the United States* 293-297 (1938). Insurance companies, bank trust departments and nonfinancial corporations purchased almost all of the remaining five percent. *Id.* at 303-304.

Glass-Steagall Act forbids commercial banks from dealing in. We now address that contention by showing that commercial paper held by large, financially sophisticated institutions other than banks continues to function as the equivalent of a traditional commercial loan to the issuer and the bank's role in the transaction is in no way inhibited by the Glass-Steagall Act.

1. A commercial loan, in its traditional form, represents a short-term extension of credit to a business to finance short-term needs.[59] By contrast, as we explained above (page 21, *supra*), a debt security such as a bond, debenture or note, ordinarily is distributed to the public, in small denominations, pursuant to a trust indenture, and for relatively long periods of time. The commercial paper involved here exhibits all of the essential criteria of the quintessential commercial loan and bears none of the significant characteristics of a debt security.[60]

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[59] *United States* v. *Connecticut National Bank*, 418 U.S. 656, 665 (1974) ("[c]ommercial loans, generally speaking, are relatively short-term loans to business enterprises of all sizes, usually for purposes of inventory or working capital"). See also D. Hayes, *Bank Lending Policies* 89-91 (2d ed. 1977); J. Culbertson, *Money and Banking* 308-309 (2d ed. 1977). The lower courts have relied on similar criteria to distinguish notes representing commercial loans from "securities" for purposes of the securities acts. See, *e.g.*, *American Bank & Trust Co.* v. *Wallace*, 702 F.2d 93, 96-97 (6th Cir. 1983); *American Fletcher Mortgage Co.* v. *United States Steel Credit Corp.*, 635 F.2d 1247, 1254 (7th Cir. 1980), cert. denied, 451 U.S. 911 (1981); *C.N.S. Enterprises, Inc.* v. *G. & G. Enterprises, Inc.*, 508 F.2d 1354, 1359-1361 (7th Cir.), cert. denied, 423 U.S. 825 (1975).

[60] A text on investment banking written by one of the major participants in the drafting of the Glass-Steagall legislation (see 75 Cong. Rec. 10070-10072 (1932) (remarks of Sen. Glass)) states that the most common factor used in approximating the distinction between commercial and investment banking is time—commercial banking involving short-term advances to borrowers and investment banking consisting of long-term advances, usually represented by securities. H. Willis & J. Bogen, *Investment Banking* 5 (1936). See also *Great Western Bank & Trust* v. *Kotz*, *supra*, 532 F.2d at 1257. While we would not single out one isolated characteristic as the determinative indicia of a commercial transaction or an investment, our submission is that the "cluster" of characteristics

First, the commercial paper placed by Bankers Trust matures on the average in 60 days (J.A. 105A); most of the paper placed through dealers has a maturity of 30 days or less.[61] These maturities accord generally with the maturity of a traditional commercial loan from a bank.[62]

As a consequence of its very short maturities, commercial paper, like a commercial loan, generally is held to maturity; there is virtually no secondary commercial paper market.[63] Moreover, also because of its short maturities, the purchasers of commercial paper bear a significantly different *kind* of risk than do investors. Whereas investors must be concerned with the overall, long-term prospects of the issuing business, holders of commercial paper need only be satisfied that the borrowing corporation has sufficient liquidity to meet its current liabilities. In addition, because there is no effective secondary market, holders of commercial paper, like other short-term lenders, generally are not affected by fluctuations in interest rates or other changes in economic conditions that may affect an investor's ability to resell a security. In sum, the risk associated with the purchase of commercial paper in the recognized market is not indicative of an investment transaction.[64]

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of which commercial paper partakes is representative of a traditional commercial loan rather than an investment transaction.

[61] Lowenstein, *supra*, at 147; *The Commercial Paper Market, supra*, at 530; Stigum, *supra*, at 632.

[62] See *Terms of Lending at Commercial Banks (August 1-5, 1983)*, 69 Fed. Res. Bull. A25 (Nov. 1983) (weighted average maturity of short-term commercial and industrial loans 1.2 months). The average maturity of commercial paper obligations at the time the Act was passed was approximately five months. Greef, *supra*, at 231.

[63] *The Commercial Paper Market, supra*, at 529; Lowenstein, *supra*, at 142; *The Commercial Paper Market Since the Mid-Seventies, supra*, at 331; Stigum, *supra*, at 641.

[64] Indeed, the risk of loss resulting from the purchase of commercial paper is significantly less even than the risk inherent in ordinary commercial loans extended by banks. See pages 40-42, *infra*.

The "short-term" bonds pointed to by petitioners (SIA Br. 16; Becker Br. 38) have longer maturities than much of the

A final consequence of the very short maturities of commercial paper is that issuers use the proceeds for the same seasonal, temporary purposes as they would use the proceeds of bank loans.[65] The well recognized fact that large corporations issue commercial paper as a substitute for seeking bank credit is additional evidence that commercial paper is the functional equivalent of a commercial loan.[66]

Furthermore, unlike bonds and debentures, commercial paper is sold only in very large denominations—

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paper placed in the commercial paper market today. More importantly, these bonds bear several other characteristics of a security, including distribution to the public in small denominations or issuance under a trust indenture, characteristics not shared by commercial paper.

[65] *The Commercial Paper Market, supra*, at 527; Lowenstein, *supra*, at 131-132. The virtual impossibility of tracing the proceeds of commercial paper (or of a commercial loan) to specific uses (SIA Br. 16) does not mean that commercial paper proceeds may be channeled into long-term assets. Because the purchasers of commercial paper can demand payment within a very short time, a corporation with commercial paper outstanding must maintain sufficient liquidity to meet any short-term demand for payment if, as frequently happens (see pages 4, *supra* & 40-41, *infra*), the corporation's rating is lowered or removed and it can no longer continue to borrow funds in the market.

Moreover, since commercial paper is sold in the recognized market without the registration statement and prospectus otherwise required by the 1933 Act, it must be used to facilitate current business transactions and must have short maturities (less than nine months), be of prime quality, and not ordinarily be sold to the public. See 15 U.S.C. 77c(a)(3); SEC Securities Act Release No. 4412, *supra*. A bank that attempts to distribute as "commercial paper" third party notes that do not have the economic characteristics relied on by the Board thus would be subject to significant risk of criminal and civil liability under the securities laws. See 15 U.S.C. 77*l*(1), 77x. In addition, such a bank would violate the Board's Guidelines and incur the risk of Board supervisory action. See J.A. 187A.

[66] *The Commercial Paper Market, supra*, at 525, 527; Lowenstein, *supra*, at 130. See also American Banker, Sept. 27, 1983, at 3, col. 1 (citing a study finding competition between commercial paper and bank loans as sources of corporate borrowing).

$1,000,000 on the average;[67] Bankers Trust does not sell commercial paper in denominations of less than $100,000 (J.A. 105A). The consequence of the very large denominations in which commercial paper is issued is that it is not affordable by the average investor;[68] Bankers Trust, for example, sells to no individuals (J.A. 106A). Rather, the paper is placed only with large, financially sophisticated institutions (J.A. 106A). The most significant purchasers of commercial paper today are money market mutual funds, which, as of May 1983, held approximately $50 billion in commercial paper, about 30% of the total outstanding.[69] The remaining two-thirds is purchased by bank trust departments and, to a lesser extent, life insurance companies, pension funds, nonprofit organizations, and nonfinancial corporations.[70]

These institutions, like banks, routinely make large purchases of short-term credit instruments as part of a regular business.[71] For example, money market mutual funds are investment companies that, among other things, provide expedited means for making purchases and redemptions of their shares.[72] The funds therefore invest

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[67] *The Commercial Paper Market, supra*, at 528.

[68] *The Commercial Paper Market Since the Mid-Seventies, supra*, at 333-334.

[69] American Banker, July 18, 1983, at 7, col. 1; 69 Fed. Res. Bull. A26 (Oct. 1983). See also *The Commercial Paper Market Since the Mid-Seventies, supra*, at 333.

[70] See, *The Commercial Paper Market, supra*, at 525, 529; *The Commercial Paper Market Since the Mid-Seventies, supra*, at 327, 333-334.

[71] See, *e.g., American Fletcher Mortgage Co.*, v. *United States Steel Credit Corp.*, 635 F.2d 1247 (7th Cir. 1980), cert. denied, 451 U.S. 911 (1981) (commercial loan participation involving bank and nonbank lenders); *Robbins* v. *First American Bank*, 514 F. Supp. 1183, 1186 (N.D. Ill. 1981) (loan participations involving pension funds); *Prudential, Travelers Follow Banks' Path with Short-Term Loans to Corporations*, Wall St. J., Jan. 27, 1983, at 32, col. 2 (short-term commercial loans by insurance companies).

[72] Report of the Staff of the Division of Investment Management of the Securities and Exchange Commission, *reprinted in Money*

the proceeds from sales of their shares in a variety of short-term credit instruments, such as bankers' acceptances and certificates of deposit as well as commercial paper.[73] Indeed, the Federal Reserve Board determined that money market mutual funds were "creditors" for purposes of the credit control regulations (see 45 Fed. Reg. 17930 (1980)) issued pursuant to the Credit Control Act, 12 U.S.C. 1901 *et seq.* (repealed).[74] Moreover, because they have substantial resources, and have access to professional advice on the money markets, nonbank purchasers of commercial paper, like commercial banks making commercial loans, are able themselves to evaluate the risk of the purchase and to verify representations about the borrowing corporation.[75] Money market funds, for example, have access to a staff of specialists, usually an external adviser, to assist the fund in evaluating the risks of placing funds in particular instruments.[76]

2. Because commercial paper is a unique instrument representative of a commercial loan transaction rather

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Market Mutual Funds: Hearings Before the Subcomm. on Financial Institutions of the Senate Comm. on Banking, Housing, and Urban Affairs, 96th Cong., 2d Sess. 31, 35 (1980).

[73] See Report of the Staff of the Division of Investment Management of the Securities and Exchange Commission, *supra*, at 32.

[74] The Credit Control Act authorized the Board, at the direction of the President, to "regulate and control any or all extensions of credit" in order to control inflation. 12 U.S.C. 1904 (repealed).

[75] Lowenstein, *supra*, at 143-144, 150, 152 ("[f]rom the viewpoint of a commercial paper purchaser, he is making a short-term commercial loan"). On the other hand, investors ordinarily lack the resources and expertise to make such determinations themselves. Cf. *SEC* v. *Ralston Purina Co.*, 346 U.S. 119, 124-125 (1953).

[76] See Report of the Staff of the Division of Investment Management of the Securities and Exchange Commission, *supra*, at 33-34.

Another indicia of a commercial loan is collateralization. See *American Bank & Trust Co.* v. *Wallace*, 702 F.2d at 96; *Great Western Bank & Trust* v. *Kotz*, 532 F.2d at 1258. While commercial paper is not collateralized per se, the existence of backup bank lines of credit in the amount of the issuer's outstanding commercial paper (see pages 4, *supra*, and 41-42, *infra*) provides a degree of assurance of repayment not available in the case of an investment.

than an investment, it is not a security for purposes of the Glass-Steagall Act. It is therefore immaterial whether the bank, in placing the paper, is engaged in an activity that, if conducted with respect to a security, would be prohibited by the Act. In any event, the role played by Bankers Trust is consistent with the view that commercial paper represents a commercial lending transaction. Since the bank places the paper only with a small number of large, financially sophisticated institutions that routinely purchase short-term credit instruments, it in effect is arranging a commercial loan from the purchasers to the issuer. Banks traditionally have performed virtually the same function in arranging loan participations or syndications.[77]

In arranging a loan participation or syndication, the lead bank solicits other lenders wishing to provide funds to a particular borrower and conveys financial information concerning the borrower to the other prospective lenders. The lead bank earns a fee, usually based on the size of the loan, contingent on successful arrangement of the participation.[78] Lenders other than commercial banks frequently are parties to loan participation and syndication transactions.[79] Loan participations and syndications have long been considered part of traditional commercial banking practice and generally are not deemed

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[77] In a syndication, all participating lenders receive a note of the borrower. In a loan participation, the lead lender usually retains the note and issues a separate participation certificate to the other lenders.

[78] See Note, *Loan Participation Agreements as Securities: Judicial Interpretations of the Securities Act of 1933 and the Securities Exchange Act of 1934*, 24 Wm. & Mary L. Rev. 295, 296-297 (1983); Pollock, *Notes Issued in Syndicated Loans—A New Test to Define Securities*, 32 Bus. Law. 537, 538 (1977); Comment, *International Loan Syndications, the Securities Acts, and the Duties of a Lead Bank*, 64 Va. L. Rev. 897, 899-900 (1978).

[79] See, *e.g.*, *American Fletcher Mortgage Co.* v. *United States Steel Credit Corp.*, 635 F.2d at 1248-1249 (commercial loan participation involving bank and nonbank lenders).

to involve "securities" even under the securities laws.[80]

3. The bank's role in placing commercial paper involves none of the "hazards" that this Court identified in determining that equity interests in a mutual fund were "securities" for purposes of the Glass-Steagall Act in *ICI I*, 401 U.S. at 629-634, 635-638. The principal reason is simply that dealings in commercial paper are relatively risk free.

This lack of significant risk is the product of many factors. First, corporations that borrow in the commercial paper market are rated by five independent credit rating services, which conduct thorough periodic investigations of the issuer's financial condition and liquidity.[81] Paper with no rating or a low rating cannot easily be placed in the market.[82] Accordingly, only the largest and finan-

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[80] See, *e.g.*, *Union Planters National Bank* v. *Commercial Credit Business Loans, Inc.*, 651 F.2d 1174, 1179-1185 (6th Cir.), cert. denied, 454 U.S. 1124 (1981); *American Fletcher Mortgage Co.* v. *United States Steel Credit Corp.*, 635 F.2d at 1253-1255; *United American Bank* v. *Gunter*, 620 F.2d 1108, 1115-1119 (5th Cir. 1980) (disapproving *Lehigh Valley Trust Co.* v. *Central National Bank*, 409 F.2d 989, 992 (5th Cir. 1969), the only court of appeals decision to have construed the securities laws to reach loan participations).

The fact that in arranging for the purchase of commercial paper by other lenders a bank may not purchase the paper for its own account does not alter the underlying character of the bank's activity (in fact, on occasion, Bankers Trust in effect does purchase some of the commercial paper it places by extending a loan to the issuer at or near the commercial paper rate in an amount representing a small portion of the unsold amount of the issue (J.A. 123A)). As we showed above (pages 37-38, *supra*), nonbank purchasers of commercial paper have the financial sophistication to assess the risks of short-term extensions of credit without relying on the judgment of third parties.

[81] *The Commercial Paper Market Since the Mid-Seventies*, *supra*, at 331; Stigum, *supra*, at 635-637. The rating services are Moody's Investors Service, Standard & Poor's Corporation, Fitch Investor's Service, Duff and Phelps, Inc., and McCarthy, Crisanti, Maffei, Inc. Moody's and Standard & Poor's are the two largest agencies.

[82] *The Commercial Paper Market Since the Mid-Seventies*, *supra*, at 327; Stigum, *supra*, at 635-637. During the past year, a relatively large number of corporations received lower ratings or lost their

cially strongest corporations are able to borrow funds in the commercial paper market.[83] Today, only about 1,200 firms have ratings from the three major credit rating services, thus defining the outer limit of corporations that are able to borrow in the commercial paper market.[84]

Second, the short maturities of the paper provide substantial protection against loss. The large, well-known corporations that use commercial paper to obtain funds are unlikely to deteriorate in 30 to 90 days. Even if financial difficulties do develop, purchasers of the paper, unlike the holders of bonds or debentures, can demand payment before the incipient problems worsen.[85]

Moreover, virtually all commercial paper issuers follow a policy of maintaining lines of credit from a commercial bank equal to 100% of the amount of their commercial paper outstanding.[86] Issuers can draw on these "back-up" lines of credit to repay their outstanding obligations if they encounter financial difficulties. The use of bank

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ratings altogether. From November 1982 to November 1983, Standard & Poor's lowered the rating of 68 corporations and no longer rated an additional 115 firms. Standard & Poor's Corp., *Commercial Paper Ratings Guide* vi-xvi (Nov. 1983).

[83] *The Commercial Paper Market, supra,* at 525, 527-528; Lowenstein, *supra,* at 129; *The Commercial Paper Market Since the Mid-Seventies, supra,* at 328.

[84] *The Commercial Paper Market Since the Mid-Seventies, supra,* at 327, 331. By contrast, approximately 3,000 corporations issue securities that are listed on the Nation's stock exchanges. 1982 SEC Ann. Rep. 106.

[85] For example, the D.H. Baldwin Co., an insurance company that, along with several affiliates, filed for bankruptcy in September 1983 (N.Y. Times, Sept. 27, 1983, at 1, col. 1), at one time was a rated commercial paper issuer. As it developed financial problems, however, Baldwin's rating was lowered in March 1983 and removed in May 1983. Standard & Poor's Corp., *Commercial Paper Ratings Guide, supra,* at xii, x. Thus, assuming Baldwin's paper bore the usual, short maturities characteristic of commercial paper, the paper would have matured before Baldwin's bankruptcy.

[86] *The Commercial Paper Market, supra,* at 530; Goldman, Sachs am. br. 11.

letters of credit also is becoming more widespread in the market. If commercial paper is backed by a letter of credit from a bank or other financial institution, the guarantor agrees to repay the holder of the paper directly if the issuer is unable to do so.[87]

The ultimate test of risk, of course, is the rate of default on commercial paper. Historically, the number of defaults by issuers of commercial paper has been nominal, even during the years of the Great Depression.[88] Indeed, even the 1970 failure of the Penn Central Transportation Company to repay its outstanding commercial paper resulted in the widespread establishment of procedures to assure that borrowers repay their obligations at maturity.[89] Due primarily to the increased surveillance of issuers in the wake of Penn Central, since 1970 there has been no default of significance in the market; the risk of holding commercial paper clearly is no greater now than when the Act was adopted in 1933.[90]

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[87] *The Commercial Paper Market Since the Mid-Seventies*, *supra*, at 332.

[88] Greef, *supra*, at 311-314. For example, from 1922 to 1935 less than one percent of the firms using the market were unable to repay their paper. *Id.* at 313-314.

[89] Stigum, *supra*, at 635; Lowenstein, *supra*, at 141; see also *The Commercial Paper Market Since the Mid-Seventies*, *supra*, at 327.

[90] The Penn Central default thus cannot be regarded as representative of the risk associated with the commercial paper market as it operates today. The four other defaults that have occurred since 1970 are de minimis as compared with the total amount of paper outstanding. See Stigum, *supra*, at 635. Moreover, at least one defaulting issuer did not issue the kind of commercial paper involved here, but rather sold obligations to the public generally in denominations as small as $3,000. *Sanders* v. *John Nuveen & Co.*, 463 F.2d 1075, 1079-1080 (7th Cir.), cert. denied 409 U.S. 1009 (1972).

SIA's contention (Br. 17) that the Act provides no exclusion for low-risk securities begs the question. As this Court indicated in *ICI I*, 401 U.S. at 630, risk is one criterion (albeit not the only one) of whether a particular obligation is a "security." Thus, if a low-risk obligation bears other indicia of an investment—for example, if a long-term obligation is distributed to the public in small

Largely for these reasons, a bank's role in placing commercial paper in the recognized market does not give rise to the hazards against which the Act was directed. First, there is no danger that as a result of its commercial paper operations Bankers Trust might be induced to use its depositors' funds to purchase "frozen" or "imprudent stock or security investments." See *ICI I*, 401 U.S. at 630. Although a bank ordinarily would not purchase with its own funds the paper it places—acting instead as the agent of the issuer—where the bank does purchase the paper for its own account such short-term paper clearly is not a frozen or imprudent security investment. Indeed, as we showed above (pages 25-29, *supra*), banks have purchased commercial paper for their own accounts since the beginning of banking in this country; the Act was intended, among other things, to encourage banks to purchase precisely the type of obligation that is involved here.

The low-risk nature of commercial paper also minimizes the possibility of there arising a perceived need for the bank to make a loan to the issuer. In addition, the nature of the commercial paper market reduces the possibility that the bank's involvement in placing the paper would "impair its ability to function as an impartial source of credit." *ICI I*, 401 U.S. at 631. The short-term nature of commercial paper combined with the rating mechanism virtually assures that as soon as a corporation begins to experience financial difficulties it will be unable to continue to borrow in the commercial paper market. Accordingly, there would be little incentive for the bank to "shore up" an issuer in order to be able to continue to place its paper.

Nor is there temptation for a bank to make a loan in order to facilitate the purchase of commercial paper. Because the interest rate on bank loans exceeds the return

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denominations—the instrument may be treated as a security. *Baker, Watts & Co.* v. *Saxon*, 261 F. Supp. 247 (D.D.C. 1966), aff'd *sub nom. Port of New York Authority* v. *Baker, Watts & Co.*, 392 F.2d 497 (D.C. Cir. 1968), on which SIA relies (Br. 17 n.19), is inapposite; no claim was made in that case that the obligations at issue were not "securities."

on commercial paper,[91] it is not profitable to purchase commercial paper with borrowed funds.[92]

The uniform financial strength of corporations that issue commercial paper also minimizes the likelihood that purchasers will suffer losses resulting in the bank's "loss of customer good will," that "public confidence in the bank might be impaired," or that the bank's "reputation for prudence and restraint would be damaged" (*ICI I*, 401 U.S. at 631-632). Moreover, not only the financial strength of the issuer, but the nature of commercial paper purchasers as well, render it highly unlikely that a bank would give unreliable investment advice (*ICI I*, 401 U.S. at 633). As we have noted, commercial paper is not offered for sale to the public at large or even to the bank's customers generally, but only to large, financially sophisticated purchasers that regularly purchase in the established short-term credit market. These purchasers have the resources to assess independently any risk posed by the paper.[93]

Finally, the high degree of promotional pressure that is associated with investment banking is not present in the commercial paper market. Rather, fees earned on the placement of commercial paper are relatively modest (usually one-eighth of one percent per year or $1250 per million per year).[94] The placement of commercial paper is by no means a major source of profit, but represents instead a means of encouraging issuers to use the other, more profitable services offered by the placing banks.[95]

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[91] Lowenstein, *supra*, at 130.

[92] J.A. 185A. During its investigation of Bankers Trust's commercial paper activities, the Board staff found "no evidence that purchasers used borrowed funds to buy the commercial paper" (J.A. 106A).

[93] Bankers Trust does not place commercial paper with fiduciary accounts to which the bank provides investment advice. J.A. 106A.

[94] Stigum, *supra*, at 639; Lowenstein, *supra*, at 132.

[95] See Lowenstein, *supra*, at 132.

D. The Board's Determination That The Commercial Paper Involved Here Is Not A "Security" Within The Meaning Of The Glass-Steagall Act Is Entitled To Substantial Deference

Petitioners contend (Becker Br. 23; see also SIA Br. 33-35; Becker Br. 20-24) that the court of appeals "abdicated its responsibility and extended unprecedented judicial deference to the Board's 'adaptation' of the Glass-Steagall Act." To the contrary, the court of appeals expressly declined (J.A. 230A) to "rest merely on the deference to the conclusions of the Federal Reserve Board." Rather, as detailed in the statement above (pages 9-11, *supra*), the court undertook its own independent, extensive analysis of the language, legislative history, and underlying purposes of the Act. As a result, the court concluded (J.A. 230A) that the Board's determination that the commercial paper involved here is not a "security" for purposes of the Act is "essentially correct." But, in any event, the Board's views *are* entitled to substantial deference.

1. We respond first to petitioners' contention (Becker Br. 8-9, 11-20, 41-42; SIA Br. 9, 11-17) that the Board's ruling is entitled to no deference because it represents an impermissible exercise of regulatory authority. Contrary to petitioners' assertions, the Board is not attempting to "regulate" the underwriting by banks of instruments that are securities within the meaning of the Glass-Steagall Act. Rather, as is evident from both the language and the reasoning employed by the Board, its ruling represents a determination that the commercial paper involved here is not a "security" for purposes of the Act and for that reason is not subject to the legislation's prohibitions. See, *e.g.*, J.A. 126A ("[b]ased on a review of all the relevant arguments and the facts of record, the Board is of the opinion that, as a legal matter, the stronger argument is that commercial paper is not a 'security' within the intendment of the Glass-Steagall Act").[96]

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[96] **Nor do the Board's Guidelines amount to regulation of activity that was intended to be prohibited by the Act. As the court of**

Such administrative line-drawing is inherently the function of an agency charged with the administration of a statute, especially one that contains such broad terms as "securities" and "notes." [97] Petitioners' contention that the Board lacks the authority to perform this function is thus nothing more than a restatement of their argument on the merits that every instrument that is denominated

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appeals noted (J.A. 226A n.17), "the guidelines in essence describe Bankers Trust's activities." Accordingly, the additional restrictions imposed by the Board on banks making similar placements (see note 17, *supra*) represent an attempt by the Board to regulate activities *outside* the reach of the Glass-Steagall Act "[p]ursuant to its authority to restrain unsafe or unsound banking practices" (J.A. 183A).

[97] Cf. *United Housing Foundation, Inc.* v. *Forman*, 421 U.S. 837, 847-848 (1975) (because Congress "did not attempt to articulate the relevant economic criteria for distinguishing 'securities' from 'nonsecurities' " for purposes of the securities laws, "[t]he task has fallen to the Securities and Exchange Commission (SEC), the body charged with administering the Securities Acts, and ultimately to the federal courts to decide which of the myriad financial transactions in our society come within the coverage of these statutes"). See also *Unemployment Compensation Commission* v. *Aragon*, 329 U.S. 143, 153 (1946).

Commencing with interpretations contemporaneous with the enactment of Glass-Steagall, the Board has applied the Act on a case-by-case basis depending on the particular facts surrounding individual types of obligations. For example, in 1934, the Board issued an opinion stating that "it is not possible to lay down any general rule as to whether or not certificates of participation based on mortgages, notes issued in series, and other similar obligations secured by mortgages * * * are included within the provisions [of the Glass-Steagall Act] since such obligations vary so widely in character." 20 Fed. Res. Bull. 302 (1934). The Board explained (*ibid.*) that questions concerning the applicability of the Act to these kinds of instruments "must be determined as and when they arise in particular cases according to the facts involved therein." Over the years, the Board has continued to resolve questions involving the coverage of the Act on a case-by-case basis depending on the economic reality of the transaction. See, *e.g.*, 12 C.F.R. 218.109 (short-term unsecured negotiable notes issued by large banks not "securities").

a note is a "security" within the meaning of the Glass-Steagall Act.[98]

2. Properly viewed as the construction of the statute by the agency charged with its administration, the Board's ruling is entitled to considerable deference.[99] Administration of the Glass-Steagall Act is shared between the Board, which enforces the Act with respect to state-chartered banks that are members of the Federal Reserve System, and the Office of the Comptroller, which enforces the Act with respect to national banks.[100] In addition to its significant authority and experience in administering the Glass-Steagall Act in particular,[101] as the Nation's

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[98] Because the Board has not attempted to "regulate" activities that are covered by the Act, petitioners' reliance (Becker Br. 12-16; SIA Br. 22-24) on occasions on which Congress has withheld regulatory authority from the administrative agencies is misplaced. A fortiori, Becker's contention that the Board has unconstitutionally exercised legislative power is frivolous. Moreover, the legislative proposals that preceded enactment of the Glass-Steagall legislation would have required either "federal inspection and constant examination of the affiliates [of banks] and * * * the control of relationships between the parent banks and its associate companies" or federal incorporation (chartering) of affiliates, and had nothing to do with the nature of the activities in which such affiliates could engage. See H. Willis & J. Chapman, *The Banking Situation* 68 (1934). The unsuccessful attempts to amend the Act cited by petitioners (SIA Br. 24; Becker Br. 15) uniformly were intended to permit public underwriting of broad classes of securities that undisputedly were subject to the Act. The failure of Congress to enact such proposals has no bearing on the Board's authority to determine whether a particular instrument is covered by the Act.

[99] See, *e.g.*, *FEC* v. *Democratic Senatorial Campaign Committee*, 454 U.S. 27, 31-32, 37-39 (1981); *Ford Motor Credit Co.* v. *Milhollin*, 444 U.S. 555, 566 (1980); *Udall* v. *Tallman*, 380 U.S. 1, 16 (1965).

[100] See *ICI I*, 401 U.S. at 626-627; *Port of New York Authority* v. *Baker, Watts & Co.*, 392 F.2d at 499. The Federal Deposit Insurance Corporation supervises state-chartered banks that are not members of the Federal Reserve System.

[101] For example, the Board is authorized to assess civil penalties for violations of Section 20 of the Act, 12 U.S.C. 377, relating to affiliations between member banks and securities firms, and to provide by regulation for exceptions from the prohibitions of Section

central bank the Board has broad responsibilities in overseeing the entire operation of the country's banking system.[102] Particularly in a case such as this one, where there is no evidence that the transaction at issue was engaged in at the time the controlling legislation was enacted, the Board has the expertise to examine the economic realities of the transaction in order to determine whether the transaction is one that Congress would have intended to reach.[103]

In *ICI II* this Court quoted with approval Justice Rutledge's description of the deference that is due the Board's construction of the Glass-Steagall Act in view of its "specialized experience" (450 U.S. at 56-57 n.21, quoting *Board of Governors of the Federal Reserve System* v. *Agnew*, 329 U.S. 441, 450 (1947) (concurring opinion) (emphasis added)):

32, 12 U.S.C. 78, relating to officer, director, or employee interlocks between a member bank and a securities firm. Becker thus errs in asserting (Br. 22) that the Act is a self-enforcing criminal statute; only one provision, Section 21, of the four key provisions is a criminal statute.

[102] The Board, through the Federal Reserve Banks, examines, supervises and enforces applicable laws with respect to state-chartered member banks as well as bank holding companies. 12 U.S.C. 325, 504, 505, 1818(b), (e), 1844 and 1847. The Federal Reserve System also takes action to control the growth of reserves held by depository institutions, 12 U.S.C. 263 and 461, and extends funds to member banks and other depository institutions, 12 U.S.C. 343 *et seq.*, 352, 357, 461(b)(7).

[103] Petitioners err in suggesting that the Board employed its expert knowledge of economic activities to permit an activity that was prohibited at the time of enactment. As we discussed above, at the time the Glass-Steagall Act was passed banks were virtually the only purchasers of commercial paper; there is no evidence of banks placing third-party commercial paper with other purchasers. The Board's expertise is thus put to use in determining whether, on the basis of the economic realities of the transaction in question, it is one that Congress would have intended to prohibit. By contrast, if petitioners' views were accepted, the universe of financial transactions would be frozen as of the enactment of Glass-Steagall; notwithstanding the considerable expertise and experience available to the Board it would be precluded from determining that any "note" transaction was not within the reach of the Act.

> Not only because Congress has committed the system's operation to their [the Board of Governors of the Federal Reserve System] hands, but also because the system itself is a highly specialized and technical one, requiring expert and coordinated management in all of its phases, I think their judgment should be conclusive upon any matter which * * * is open to reasonable difference of opinion. Their specialized experience gives them an advantage judges cannot possibly have, *not only in dealing with the problems raised for their discretion by the system's working, but also in ascertaining the meaning Congress had in mind in prescribing the standards by which they should administer it.* Accordingly their judgment in such matters should be overturned only where there is no reasonable basis to sustain it or where they exercise it in a manner which clearly exceeds their statutory authority.

In *ICI I*, 401 U.S. at 626-627, as well, the Court recognized the "great weight" that generally is due "any reasonable construction" of the Act by the agencies charged with its enforcement. To be sure, in that case the Court refused to defer to the Comptroller's construction of Sections 16 and 21. But that was because he had "adopted no expressly articulated position at the administrative level as to the meaning and impact of [those provisions]." 401 U.S. at 627. By contrast, here the Board promulgated a statement explaining in detail the reasons for its construction of the Act, "recogniz[ing] and address[ing] the concerns that led to the enactment of the Glass-Steagall Act." *ICI II*, 450 U.S. at 68. That construction, which was entirely consistent with prior rulings concerning commercial paper,[104] is entitled to substantial deference.

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[104] Although this is the first occasion afforded the Board to rule on the precise question presented here, as early as 1971 the Office of the Comptroller had opined that because commercial paper is not a "security" within the meaning of Glass-Steagall, that Act does not prohibit a national bank from acting as a commercial paper dealer. See J.A. 28A-31A.

It is manifest that the recent rulings by agencies other than the Board concerning other types of instruments and activities on

CONCLUSION

The judgment of the court of appeals should be affirmed.

Respectfully submitted.

REX E. LEE
Solicitor General

RICHARD K. WILLARD
Acting Assistant Attorney General

LOUIS F. CLAIBORNE
Deputy Solicitor General

BARBARA E. ETKIND
Assistant to the Solicitor General

ANTHONY J. STEINMEYER
Attorney

MICHAEL BRADFIELD
General Counsel

RICHARD M. ASHTON
Assistant General Counsel
Board of Governors of the Federal Reserve System

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which petitioners rely (Becker Br. 17-19; SIA Br. 35) have no significant bearing on the lawfulness vel non of the Board's action here. In any event, the legality of these other rulings has yet to be finally determined. Indeed, two courts have upheld administrative decisions permitting banking organizations to offer brokerage services. See *SIA* v. *Board of Governors of the Federal Reserve System*, 716 F.2d 92 (2d Cir. 1983), petition for cert. pending, No. 83-614; *SIA* v. *Conover*, No. 82-2865 (D.D.C. Nov. 2, 1983).

APPENDIX

12 U.S.C. 24 (Seventh), as amended by Section 16 of the Glass-Steagall Act, ch. 89, 48 Stat. 184, provided:

> [A] national banking association * * * shall have power—
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> * * * * *
>
> To exercise by its board of directors or duly authorized officers or agents, subject to law, all such incidental powers as shall be necessary to carry on the business of banking; by discounting and negotiating promissory notes, drafts, bills of exchange, and other evidences of debt; by receiving deposits; by buying and selling exchange, coin, and bullion; by loaning money on personal security; and by obtaining, issuing, and circulating notes according to the provisions of this title. The business of dealing in investment securities by the association shall be limited to purchasing and selling such securities without recourse, solely upon the order, and for the account of, customers, and in no case for its own account, and the association shall not underwrite any issue of securities: *Provided*, That the association may purchase for its own account investment securities under such limitations and restrictions as the Comptroller of the Currency may by regulation prescribe, but in no event (1) shall the total amount of any issue of investment securities of any one obligor or maker purchased after this section as amended takes effect and held by the association for its own account exceed at any time 10 per centum of the total amount of such issue outstanding, but this limitation shall not apply to any such issue the total amount of which does not exceed $100,000 and does not exceed 50 per centum of the capital of the association, nor (2) shall the total amount of the investment securities of any one obligor or maker purchased after this section as amended takes effect and held by the association for its own account exceed at any time 15 per centum of the amount of the capital

stock of the association actually paid in and unimpaired and 25 per centum of its unimpaired surplus fund. As used in this section the term 'investment securities' shall mean marketable obligations evidencing indebtedness of any person, copartnership, association, or corporation in the form of bonds, notes and/or debentures commonly known as investment securities under such further definition of the term 'investment securities' as may by regulation be prescribed by the Comptroller of the Currency. Except as hereinafter provided or otherwise permitted by law, nothing herein contained shall authorize the purchase by the association of any shares of stock of any corporation. The limitations and restrictions herein contained as to dealing in, underwriting and purchasing for its own account, investment securities shall not apply to obligations of the United States, or general obligations of any State or of any political subdivision thereof, or obligations issued under authority of the Federal Farm Loan Act, as amended, or issued by the Federal Home Loan Banks or the Home Owners' Loan Corporation: *Provided*, That in carrying on the business commonly known as the safe-deposit business the association shall not invest in the capital stock of a corporation organized under the law of any State to conduct a safe-deposit business in an amount in excess of 15 per centum of the capital stock of the association actually paid in and unimpaired and 15 per centum of its unimpaired surplus.

The restrictions of this section as to dealing in investment securities shall take effect one year after the date of the approval of this Act.

12 U.S.C. 24 (Seventh), as further amended by Section 308 of the Banking Act of 1935, ch. 614, 49 Stat. 709, provided:

[A] national banking association * * * shall have power—

* * * * *

To exercise by its board of directors or duly authorized officers or agents, subject to law, all such incidental powers as shall be necessary to carry on the business of banking; by discounting and negotiating promissory notes, drafts, bills of exchange, and other evidences of debt; by receiving deposits; by buying and selling exchange, coin, and bullion; by loaning money on personal security; and by obtaining, issuing, and circulating notes according to the provisions of this title. The business of dealing in securities and stock by the association shall be limited to purchasing and selling such securities and stock without recourse, solely upon the order, and for the account of, customers, and in no case for its own account, and the association shall not underwrite any issue of securities or stock: *Provided*, That the association may purchase for its own account investment securities under such limitations and restrictions as the Comptroller of the Currency may by regulation prescribe. In no event shall the total amount of the investment securities of any one obligor or maker, held by the association for its own account, exceed at any time 10 per centum of its capital stock actually paid in and unimpaired and 10 per centum of its unimpaired surplus fund, except that this limitation shall not require any association to dispose of any securities lawfully held by it on the date of enactment of the Banking Act of 1935. As used in this section the term "investment securities" shall mean marketable obligations, evidencing indebtedness of any person, copartnership, association, or corporation in the form of bonds, notes and/or debentures commonly known as investment securities under such further definition of the term "investment securities" as may by regulation be prescribed by the Comptroller of the Currency. Except as hereinafter provided or otherwise permitted by law, nothing herein contained shall authorize the purchase by the association for its own account of any shares of stock of any

corporation. The limitations and restrictions herein contained as to dealing in, underwriting and purchasing for its own account, investment securities shall not apply to obligations of the United States, or general obligations of any State or of any political subdivision thereof, or obligations issued under authority of the Federal Farm Loan Act, as amended, or issued by the Federal Home Loan Banks or the Home Owners' Loan Corporation, or obligations which are insured by the Federal Housing Administrator pursuant to section 207 of the National Housing Act, if the debentures to be issued in payment of such insured obligations are guaranteed as to principal and interest by the United States: *Provided*, That in carrying on the business commonly known as the safe-deposit business the association shall not invest in the capital stock of a corporation organized under the law of any State to conduct a safe-deposit business in an amount in excess of 15 per centum of the capital stock of the association actually paid in and unimpaired and 15 per centum of its unimpaired surplus.

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